STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	)	
	)	ICC Docket No. 10-0237
Peoples Gas Light & Coke Company	)	ICC Docket No. 10-0238
	)	(Consolidated)
Petition Pursuant to Rider VBA	)	
of Schedule of Rates for Gas	)	
Service to Initiate a Proceeding to	)	
Determine the Accuracy of the	)	
Rider VBA Reconciliation Statement	)	

BRIEF OF
THE PEOPLE OF THE STATE OF ILLINOIS

The People of the State of Illinois, by and through Lisa Madigan, Attorney General of the State of Illinois ("the People"), pursuant to Part 200.800 of the Rules of Practice of the Illinois Commerce Commission ("the Commission"), 83 Ill. Admin. Code 200.800, hereby file their Initial Brief in the above-captioned proceeding.

I. Introduction

On March 29, 2010,Peoples Gas Light & Coke Company ("Peoples Gas") and North Shore Gas Company ("North Shore", together "the Companies") filed a petition initiating the annual reconciliation of charges and credits applied to customers in Service Classification 1 (Residential) and 2 (General Service[1]) through the Companies' respective decoupling tariffs known as Rider VBA (Volume Balancing Adjustment). The subject reconciliation period is the period of January 1, 2009 through December 31, 2009. PGL Ex. 1.0 at 3; NSG Ex. 1.0 at 3. Rider VBA was approved by the Commission on a four-year pilot basis in ICC Docket No. 07-0241, 07-0242, a consolidated rate case. ICC Docket Nos. 07-0241, 07-0242 (cons.), Order of February 5, 2008 ("2008 Rate Order") at 150-152. Under Rider VBA, Rate 1 Residential and

[1] General Service customers are typically small commercial customers.

Rate 2 General Service customer rates are adjusted on a monthly basis to account for the difference between the baseline distribution *margin revenue per customer* established in the Companies' most recent rate case – in this instance, ICC Docket No. 09-0166, 09-0167 (cons.) -- and the actual distribution margin revenue per customer experienced in the second month prior to the effective month of the adjustment.[2] *See* Peoples Gas Ex. VG-1.0 at 47; NS Ex. VG-1.0 at 42-43, ICC Docket Nos. 07-0241, 07-0242 (cons.). As justification for Rider VBA, the Commission specifically concluded that the rider would help offset revenues losses associated with alleged declining and variable (per customer) energy usage in general, as well as specific declines associated with customer participation in Peoples' and North Shore Gas Company's ("the Companies") new energy efficiency programs. 2008 Rate Order at 150-152.

In recognition of the significant opposition to Rider VBA by the Commission Staff, the People, the Citizens Utility Board and the City of Chicago, and the novel surcharges and credits that it would bring to customers' bills, the Commission stated it would "be ever vigilant in our oversight of the deployment and impact of this new rider." 2008 Rate Order at 152. It further required the Company to file an annual audit of the rider and the Commission Staff to provide Commissioners an annual report on the Companies' rates of return and the effect on that return of Rider VBA, "to the extent that is determinable by Staff." *Id.*

As discussed below, the People do not object to the reconciliation amounts that have, since the filing of the subject petitions, gone into effect during the April through December 2010 time period. However, on September 30, 2010, the Second District Appellate Court issued a

[2] The difference between the last rate case baseline margin revenue level and actually experienced margin revenue per customer is multiplied by the rate case number of customers and then divided by the number of therms estimated for the effective month of the adjustment, yielding the monthly per therm adjustment. Any difference between actual billed revenues arising from distribution charges plus the adjustment and approved distribution margin under the rider is reconciled on an annual basis and amortized over a 10-month period beginning in March, 2008, with any resulting positive or negative adjustment added to customers' bills during that period. Peoples Ex. VG-1.0 at 47, ICC Docket Nos. 07-0241, 07-0242.

ruling in *Commonwealth Edison Co. v. Ill. Commerce Comm'n, et al.*, 2010 Ill. App. LEXIS 1057, (2nd District 2010) at 37 ("*Commonwealth Edison* decision"), in which the Court specifically examined and outlined the conditions under which Commission approval of riders as cost recovery mechanisms is permissible. *Commonwealth Edison*, No. 2-08-0959 at 10-11 and 34-43. That decision strictly defined and limited the circumstances under which riders can be authorized by the Commission.

As discussed below, the People believe the evidence in this Docket shows that Rider VBA is unlawful under the *Commonwealth Edison* decision, because it does not fit the two-part test for permissible riders established by the Court. The continued operation of Rider VBA would be in contravention of Illinois law. As such, the People request that the Commission (1) enter an order that approves the requested Reconciliation Amounts for the 2010 period in question, thereby reconciling the 2009 Rider VBA surcharges and credit amounts; (2) terminate Rider VBA as of the date of the Order in this Docket, and (3) order the Companies to file a reconciliation petition that reconciles the amounts collected and refunded under Rider VBA for the 2010 calendar year and the period up to the date of this Order.

II. The Evidence Regarding the Reconciliation of Rider VBA

A. The Reconciliation Amounts at Issue

The petition and testimony presented by the Companies requests approval of the calculated reconciliation adjustment surcharges and credits that were put into effect over the nine-month period of April 1, 2010 through December 31, 2010. PGL Ex. 1.0 at 3; NS Ex. 1.0 at 3. As noted above, these reconciliation amounts are intended to true-up the amounts collected and refunded under Rider VBA for the 2009 calendar year.

For North Shore customers, the testimony submitted by the Companies in this docket showed that the Reconciliation Adjustment ("RA") generated a charge of 0.25 cents per therm and a credit of 0.14 cents per therm for S.C. 1 (Residential) sales and transportation customers, respectively. Over the nine-month period beginning April 1, 2010, North Shore recovered $236,508.23 from S.C. 1 sales customers and refunded $7,185.79 to S.C. 1 transportation customers. NSG Ex. 1.0 at 7; NSG Ex. 1.1. For North Shore S.C. 2 (Commercial) sales and transportation customers, a charge of 0.08 cents per therm and 0.22 cents per therm, respectively, was assessed. Over the nine-month period of April 1, 2010, North Shore recovered $18,106.62 from S.C. 2 sales customers and $76,926.72 from S.C. 2 transportation customers. NSG Ex. 1.0 at 7-8; NSG Ex. 1.1.

For Peoples Gas S.C. 1 (Residential) sales and transportation customers, a charge of 0.60 cents per therm and a credit of 1.54 cents per therm, respectively, was assessed. Over the nine-month period beginning April 1, 2010, Peoples Gas recovered $2,035,352.60 from S.C. 1 sales customers and refunded $360,648.34 to S.C. 1 transportation customers. PGL Ex. 1.0 at 7; PGL Ex. 1.1. For Peoples Gas S.C. 2 (Commercial) sales and transportation customers, a charge of 0.30 cents per therm and 0.41 cents per therm, respectively, was assessed. Over the nine-month period of April 1, 2010, Peoples Gas recovered $518,632.10 from S.C. 2 sales customers and $836,751.03 from S.C. 2 transportation customers. PGL Ex. 1.0 at 7-8; PGL Ex. 1.1.

The People do not challenge the accuracy of these reconciliation amounts. The Commission Staff reported, too, in hearings that they would not be filing testimony challenging the Companies' reported RA amounts. The People urge the Commission to approve the aforementioned Reconciliation Adjustments.

B. The Rate of Return Reports

As noted above, the Commission's 2008 Rate Order authorizing Rider VBA further required the Company to file an annual audit of the rider and the Commission Staff to provide Commissioners an annual report on the Companies' rates of return and the effect on that return of Rider VBA, "to the extent that is determinable by Staff." 2008 Rate Order at 152. In accordance with this directive, the Companies filed supplements to their Petitions which showed the following reported rates of return and returns on equity:

	With Rider VBA		**Without Rider VBA**	
	ROR	**ROE**	**ROR**	**ROE**
North Shore	4.74%	4.32%	5.08%	4.93%
Peoples Gas	4.29%	4.05%	4.59%	4.58%

Supplement to Petition of April 20, 2010.

These numbers unequivocally reflect that the Company's profit levels (and revenue requirement) are impacted by the amounts collected and refunded under Rider VBA. Stated another way, as clearly shown above, the Companies' rates of return are directly impacted by the existence of Rider VBA. The impact on each company's rate of return in 2009 is not a one-time occurrence either. The Companies' rates of return and returns on equity were likewise impacted by Rider VBA during its first year of operation in the 2008 calendar year. *See* ICC Docket Nos. 09-0123, Order of February 10, 2010 at 3, *citing* ICC Ex. 1.0 at 7-8; ICC Docket No. 09-0124, Order of February 10, 2010, *citing* ICC Ex. 1.0 at 7-8; *see also* ICC Docket No. 09-0123, ICC Ex. 1.0, Attachment B; ICC Docket No. 09-0124, ICC Ex. 1.0, Attachment B.

These facts are relevant to the People's request that the Rider VBA pilot be terminated, as further discussed below.

III. The Second District Appellate Court's Recent *ComEd* Decision Renders the Continued Operation of Rider VBA Unlawful.

As noted in the Introduction of this Brief, a recent decision entered by the Second District Appellate Court renders the continued operation of Rider VBA unlawful. In *Commonwealth Edison Co. v. Ill. Commerce Comm'n, et al.*, 2010 Ill. App. LEXIS 1057, (2nd District 2010), the Illinois Appellate Court specifically examined and outlined the conditions under which Commission approval of riders as cost recovery mechanisms is permissible. *Commonwealth Edison*, No. 2-08-0959 at 10-11 and 34-43. The Court noted the risk of single-issue ratemaking requires that all riders be closely scrutinized to prevent overstatement or understatement of the overall revenue requirement. This decision is attached to this Brief as Appendix A.

In *Commonwealth Edison*, the AG and the Citizens Utility Board (referred to as GC or Government and Residential Consumer Petitioners, or "GC" in the opinion) appealed the Commission's decision in ICC Docket No. 07-0566 approving Rider SMP, a rider that recovered capital and operating expenses associated with the Company's Phase 0 smart grid pilot. AG/CUB argued, *inter alia,* that the Commission erred in approving the rider because it violated the rule against single-issue ratemaking and the Commission's decision was not supported by substantial evidence. The Court agreed with AG/CUB, and reversed the Commission's approval of ComEd's AMI pilot rider. In doing so, the court carefully examined recent Illinois cases involving riders (*Id.* at 37-41) and concluded that exceptional circumstances necessary to justify a rider arise only when the proposed rider is designed to "recover a particular cost if (1) the *cost* is imposed upon the utility by an external circumstance over which the utility has no control and (2) the *cost* does not affect the utility's revenue requirement." *Id.* at 41 (emphasis added). The Court further held:

> In other words, a rider is appropriate only if the utility cannot influence the cost (*Citizens Utility Board,* 166 Ill.2d at 138 ['a rider mechanism is effective and appropriate for cost recovery when a utility is faced with unexpected, volatile, or fluctuating expenses') and the expense is a pass-through item that does not change *other expenses or increase income* (*Citizens Utility Board,* 166 Ill.2d at 138 (*a valid rider has no 'direct impact on the utility's rate of return*').

Commonwealth Edison, slip opinion at 41.

In its review of Illinois law, the Court reconciled and distinguished past cases affirming Commission approval of riders that involved the recovery of expenses related to the purchase of natural gas, federally-mandated environmental remediation costs and a municipality's franchise fee. The Court concluded:

> In each instance, the expense was an externality imposed on the utility, and the expense was passed directly on to the consumer without affecting the utility's return on investment.

Id. at 41-42. The Court in *Commonwealth Edison* concluded that the AMI pilot rider approved by the Commission was unlawful because it did not meet these criteria. *Id.* at 37. While the Commission recently filed a Petition for Leave to Appeal with the Illinois Supreme Court and ComEd has indicated its intention to likewise file a PLA in late January, the Commission is obliged to follow the law of the *ComEd* decision. A judgment of the appellate court is final when entered. *PSL Realty Co. v. Granite Inv. Co.*, 86 Ill. 2d 291, 304 (1981).

The recovery of lost revenues under Rider VBA, which was premised on the alleged need to recover lost revenues in the face of energy efficiency programs, customer conservation associated with the price of natural gas and any other factor affecting usage, including weather, does not constitute the type of pass-through "costs" that qualify for rider treatment under the two-prong test articulated in *Commonwealth Edison.* Lost revenues are not "costs" that are "imposed upon the utility by an external circumstance over which the utility has no control" and are not "costs" that "do(es) not affect the utility's revenue requirement." *Commonwealth Edison,* slip opinion at 41. As shown above, the Companies' Rider VBA *will* indeed "affect the utility's revenue requirement", as revealed by the return on equity and overall rate of return figures highlighted above.

While the People concede that many Peoples Gas and North Shore customers received net credits under Rider VBA, largely attributable to the abnormally cold winters of 2008 and 2009, other customers did not fare as well. For example, North Shore's Residential transportation customers (customers who purchase gas from alternative retail gas suppliers), did *not* receive net credits in 2009. They were assessed additional distribution service charges of $19,175.94 under Rider VBA. NSG Ex. 1.1, p. 2 of 4, line 7. With regard to Peoples Gas, S.C. 1 (Residential) transportation customers and S.C. 2 (Commercial) customers were assessed an additional $39,479.22 and $463,319.80, respectively, for distribution service under Rider VBA. PGL Ex. 1.1, p. 2 of 4, line 7; AG Cross Ex. 3, pp. 1-2 of 9.

Like the illegal rider rejected in the *Commonwealth Edison decision,* Rider VBA ignores the possibility that the amounts designated to be collected (or refunded) through the rider – in this instance, foregone revenues tied to the Companies' energy efficiency programs, customer conservation and abnormally warm weather -- will be offset by revenues not accounted for in the establishment of the revenue requirement set in its last rate case. For example, it is possible that new revenues associated with the addition of new customers will offset any specific revenue losses tied to energy efficiency programs. Additionally, the foregone revenues PGL/NS seek to recover through Rider VBA could be offset by reductions in operating expenses associated with achieved efficiencies. These changes in revenues and expenses – both positive and negative – all affect a utility's revenue requirement and rate of return. The Commission, too, now has concrete evidence that decoupling mechanisms affect a utility's rate of return; both the Companies' return on equity and overall rate of return figures, as computed by the Companies, were impacted by Rider VBA in both 2008 and 2009.[3] In short, recovery of lost per customer revenues associated with conservation, energy efficiency and abnormal weather do not fall into the category of expenses defined by the Court as appropriate for rider recovery.

IV. Rider VBA Offers No Information to the Commission about What Effects Customer Gas Usage.

Rider VBA was approved because the Commission accepted PGL/NS arguments that lost revenues associated with the Companies' energy efficiency programs, as well as the price of natural gas and customers' desire to conserve related to that cost, would reduce per customer usage going forward. 2008 Rate Order at 150-152. Yet, the Companies indicated in response to AG discovery that these factors do not specifically enter into the calculation of the forecasted "Factor T" and the "Effective Component" included in the statement to the Commission showing the Rider VBA adjustment to be effective each month. AG Cross Ex. 3, pp. 3, 4. Likewise, assumptions about customers' gas usage habits in relation to the price of natural gas and energy efficiency programs are not specifically reflected in the Reconciliation Adjustments described by PGL/NS witness Valerie Grace. AG Cross Ex. 3, pp. 5-8. The Company further admits that annual weather–normalized usage per customer is not a factor in the calculations of the reconciliation adjustments, and refuses to respond when asked whether *weather-normalized* usage per customers is, in fact, declining. *Id.* at p. 9. One wonders what lessons learned the Companies plan to present to the Commission at the conclusion of the pilot. The evidence in this docket suggests that Rider VBA is nothing more than a complicated mechanism to put revenue

[3] In ICC Docket No. 09-0123, North Shore Gas Company reported that the rate of return for 2008 including Rider VBA results to be 6.08% and the rate of return for 2008 excluding Rider VBA results to be 6.42%. In ICC Docket No. 09-0124, the Peoples Gas reported that the return on equity for 2008 including Rider VBA results to be 5.19% and the return on equity for 2008 excluding Rider VBA results to be 5.44%. In this eight-month time period, per customer usage actually exceeded the per customer levels established in the prior rate case, primarily due to colder than normal weather.

streams on auto-pilot. Ironically, it has not lessened the need for rate cases. The Companies filed a rate case within two years of the implementation of Rider VBA. Certainly, the Rider VBA line item on monthly bills is incomprehensible to any customer opening his or her bill. Even if a customer understood the operation of the tariff, the recognition that they may pay more for using less arguably squelches the desire to use less natural gas. The experimental aspect of the pilot tariff is hardly being analyzed to date.

For all of these reasons, Rider VBA should be terminated as of the date of the Order in this Docket. The Commission should further order the Companies to file a reconciliation petition within 30 days that reconciles the amounts collected and refunded under Rider VBA for the 2010 calendar year and the period up to the date of this Order.

V. Conclusion

WHEREFORE, for the above stated reasons, the People of the State of Illinois urge the Commission to enter an order in accordance with the recommendations made in this Brief.

Respectfully submitted,

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